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CANADA-U.S. LUMBER TRADE DISPUTES

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Introduction

- Since 1982 Canada and the US have been involved in three lumber trade disputes (widely called Lumber I, II and III). The Softwood Lumber Agreement avoided a fourth dispute for five years until April 2001, when the latest dispute (Lumber IV) commenced.
- BC, which historically accounted for over 60% of Canadian exports to the US, has always been the prime target of these disputes.

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Background on Countervailing Duty Investigations

- Past trade disputes between the U.S. and Canada have taken the form of countervailing duty cases.
- Under U.S. trade law, a countervailing duty case is an investigation of an alleged subsidy that provides an importer with an advantage in the U.S. market. With lumber, the U.S. contends that provincial stumpage and, more recently, B.C.'s log export restrictions, provide a subsidy to lumber producers. Other provincial programs may also be alleged to provide subsidies.
- To impose a countervailing duty or tariff, the U.S. must establish two things:

    1. Subsidy - imported goods are subsidized.
    2. Injury - the subsidized goods are injuring the U.S. industry.

- Two factors determine whether goods are subsidized:

    1. Specificity - programs are available only to a specific industry.

2. Preferentiality - goods are provided at a preferential rate. 105-07246/

- The U.S. Department of Commerce investigates subsidy, while the quasi-judicial International Trade Commission investigates injury. Each agency makes a preliminary and then a final determination.
- Following a Department of Commerce preliminary determination of subsidy, bonds are required on shipments to the U.S. If the Department of Commerce finds that "critical circumstances" apply, this duty can be made retroactive for 90 days. After the final determinations of the Department of Commerce and the International Trade Commission, a countervailing duty order is issued and cash deposits are required on shipments.
- Since 1988, Canada has been able to appeal a countervailing duty to an arbitration panel established under the Free Trade Agreement (now NAFTA). However, a NAFTA panel can only determine whether the finding was made in accordance with U.S. law. An appeal can also be made to a WTO panel, which can determine whether U.S. law is consistent with the WTO.

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Background on Anti-Dumping Investigations

- Under U.S. trade law, an anti-dumping case is an investigation on whether an importer is selling goods in the U.S. at prices lower than in the home market or is selling goods at prices below cost.
- The U.S. lumber industry coalition filed its first petition for an anti-dumping investigation during Lumber IV.
- An anti-dumping case also involves the Department of Commerce and the International Trade Commission. It follows similar steps to a countervailing duty case, but generally the timetable is longer.
- With lumber, the Department of Commerce may investigate a sample of companies in extreme detail. If the Department of Commerce determines a dumping margin exists for companies in that sample, the agency will impose duties on those companies and a weighted average duty on all non-investigated companies.

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Roles and Responsibilities

Countervailing Duty Cases

- The federal government has overall responsibility for international trade, and it co-ordinates the national defence activities. Provincial governments have the lead in addressing the allegations of subsidy that relate to provincial programs. Industry has the lead in rebutting claims of injury.
- In the most recent case, the provincial government engaged Akin Gump—one of the top law firms in Washington, DC, assembled an experienced team of officials in Victoria, and established working relationships with industry and the federal government.

Anti-Dumping Cases

- Industry has the lead on an anti-dumping case as individual companies are investigated. The federal government is not a direct participant in an anti-dumping case but has overall responsibility for international trade and monitors the investigation to ensure it is in accordance with the WTO.

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History of Previous Countervailing Duty Cases (Lumber I - III)

Lumber I

- In October 1982, the Department of Commerce investigated the stumpage programs of B.C., Alberta, Ontario and Quebec. In May 1983, the Department of Commerce ended its investigation, finding that stumpage programs were not countervailable because stumpage was generally available and not limited to a specific industry (i.e., the specificity test was not met).

Lumber II

- The Department of Commerce started another investigation in May 1986.
- Two things changed between the end of Lumber I and the onset of Lumber II: The Department of Commerce began to more aggressively apply U.S. trade law, especially in natural resource countervailing duty cases. More important, the Coalition for Fair Lumber Imports – the U.S. lumber industry coalition – became a large, well-funded and politically well-connected lobby group. The coalition also retained Dewey Ballantine, an aggressive Washington, D.C., legal firm.
- Contrary to its 1983 determination, the Department of Commerce found that stumpage programs did meet the specificity test, and levied a 15 per cent tariff in its October 1986 preliminary determination. The preferentiality benchmark used by the Department of Commerce was "cost to government." The Department of Commerce determined that stumpage revenues received by provincial governments were exceeded by applicable government costs.
- A final determination was never reached. The case ended when Canada and the U.S. agreed, in December 1986, to a memorandum of understanding (MOU) under which Canada imposed a 15 per cent export charge on lumber exports to the U.S.
- The MOU had the advantages of:
    - Keeping the money in Canada - the export charge was collected by Canada and remitted to the provinces.
    - Providing certainty on the rate - a countervailing duty is essentially an interim rate; the Department of Commerce determines the rate annually and retroactively applies the newly determined rate.

- The MOU let provinces replace the export charge through increased stumpage or other policy changes. B.C. implemented replacement measures in October 1987 – increasing stumpage and transferring the responsibility for silviculture to industry.

Lumber III

- In B.C., the MOU was increasingly seen as an infringement of provincial sovereignty. The Department of Commerce monitored the B.C. replacement measures regularly and challenged every small adjustment.
- Pressure grew within Canada, especially in B.C., to get rid of the MOU. Canada's attempts to have the U.S. agree to termination were rebuffed; eventually, in October 1991, Canada unilaterally terminated the MOU.
- Almost immediately, the Department of Commerce started an investigation and imposed temporary bonding requirements. It was the first time the department had initiated a countervailing duty case on its own.
- In May 1992, the Department of Commerce issued a final determination, which set a countervailing duty rate of 6.51 per cent. The rate was comprised of two elements: A weighted average rate of 2.91 per cent for stumpage programs in B.C., Alberta, Ontario and Quebec. The finding of subsidy in B.C. was based on the difference between stumpage rates under the small business program and rates for major licensees (a change in methodology from Lumber II). A rate of 3.6 per cent for B.C.'s log export restrictions (based on that by restricting log exports, the domestic log supply is increased and the domestic log price decreased).
- Canada appealed the Department of Commerce's subsidy finding and the International Trade Commission's injury finding to binational panels under the Free Trade Agreement. After a number of redeterminations by the two agencies and further appeals by Canada, the Department of Commerce finally reversed its finding – consistent with the panel decision.
- The U.S. then challenged the panel's decision to an extraordinary challenge committee, also established under the Free Trade Agreement. The committee affirmed the panel's decision, and the Department of Commerce revoked the countervailing duty order in August 1994.

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The 1996 Softwood Lumber Agreement

- In December 1994, Canada and the U.S. agreed to implement a consultative process on lumber trade as an alternative to another trade dispute.
- Canada agreed to the consultative process, in part because the U.S. agreed to refund a significant part of the duties collected in Lumber III (about $500 million), and the U.S. Lumber Coalition agreed to drop a constitutional challenge against the Free Trade Agreement arbitration panel process.
- Both the U.S. and Canadian governments were keen to keep lumber out of another legal case. The countervailing duty cases had become increasingly acrimonious and were souring Canada-U.S. trade relations.

- Also, in its implementation of the WTO Uruguay Round agreement, the U.S. had amended its trade law to ensure that Canada could not succeed on the same basis as in Lumber III.
- The consultations led to the negotiation of the five-year Softwood Lumber Agreement in April 1996.
- The agreement limited U.S. lumber exports from B.C., Alberta, Ontario and Quebec to 14.7 billion board feet (fee-free base) annually, with escalating fees payable on shipments over that volume. The U.S. agreed not to initiate a trade case for the duration of the agreement.
- However, the Softwood Lumber Agreement did not bring the expected five years of trade peace. The U.S. challenged B.C.'s 1998 stumpage reduction under the dispute settlement provisions of the agreement. U.S. Customs, on at least three occasions, reclassified products from tariff codes outside the softwood lumber agreement into codes covered by the agreement. Canada and the U.S. agreed to negotiated settlements in the stumpage and rougher headed lumber cases. On March 29, 2001, the arbitral panel ruled that the United States breached the softwood lumber agreement when it chose to reclassify drilled studs and notched lumber.
- The Softwood Lumber Agreement, and the quota system within it, also seriously hampered B.C. industry – especially coastal companies that were unable to access the U.S. market following the collapse of the Japanese market in 1997-1998.

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The Current Softwood Lumber Dispute (Lumber IV)

- Following the expiration of the Softwood Lumber Agreement, on April 2, 2001, the U.S. Coalition for Fair Lumber Imports filed a countervailing duty petition and its first anti-dumping petition against Canadian softwood lumber.
- British Columbia has followed a three-track approach in dealing with the softwood lumber trade issue. The government has defended its programs during the litigation of the countervailing duty case, and supports challenges, both under the NAFTA and at the WTO. The government actively participated in discussions with the American government about possible policy changes that could lead to a resolution of the issue. It also supports market diversification and increased advocacy within the U.S. on the softwood lumber issue.

Litigation

Countervailing Duty (CVD) Case

- As part of the investigation, the US Department of Commerce (Commerce) issued a series of questionnaires to the federal and provincial governments. Canada's first response was filed on June 28; British Columbia's portion totalled 20 volumes. Canada filed responses to supplemental questionnaires on August 3, and December 17, 2001.
- The International Trade Commission made a preliminary determination on May 16, 2001 that the alleged subsidies pose a threat of injury to the US industry.
- On August 9, 2001, Commerce made its preliminary determination that Canadian softwood lumber exports to the United States were subsidized

at a rate of 19.31 percent. It compared BC stumpage rates with those of Washington State and did similar calculations for other provinces. In addition, Commerce found that "critical circumstances" were present in the case, deciding that there was a "massive surge" in Canadian softwood lumber exports to the US in the three months following the expiry of the Softwood Lumber Agreement. As a result, lumber producers were required to post bonds to cover duties on all lumber shipments made to the US beginning May 2001.

- Softwood lumber producers that do not benefit from the programs under investigation may be eligible for exclusion from the investigation. Only one lumber producer from the Yukon was excluded from the countervailing duty investigation at the time of the preliminary determination, because it sourced its timber from private land.
- The countervailing duty investigation was aligned with the anti-dumping case. As a result, the final subsidy determinations in both cases took place on March 21, 2002.
- Under the WTO, a provisional countervailing duty order can apply for a maximum of four months. Between December 15, 2001 and the final determination in May 2002 (the "gap period"), countervailing duties were not required for lumber shipments to the US.

Anti-Dumping Case

- As noted above, anti-dumping cases are investigations of companies. The US Department of Commerce issued anti-dumping questionnaires to six Canadian companies—Canfor, Slocan, West Fraser, Weyerhaeuser, Abitibi Consolidated and Tembec.
- In its preliminary determination on October 31, 2001, Commerce applied company-specific rates to the six investigated companies; all other Canadian companies were subject to the average rate of 12.58%.
- Companies were required to post bonds to cover duties for an initial six-month period, after which there was a brief duty-free period until the final order was published in May 2002.

Final Determination

- On March 22, 2002 the United States Department of Commerce announced its "final determination" in the subsidy and dumping cases involving Canadian exports of softwood lumber products. Contrary to the Preliminary Determination, the Final Determination did not find critical circumstances, hence the CVD would take effect in August 2001 rather than being retroactive to May 2001. Forest Renewal BC grants and assistance under the Job Protection Commission (JPC) to lumber producers were found to be countervailable.
- On April 25, 2002, Commerce released revised final determinations in the subsidy and antidumping cases. The final subsidy rate was determined to be 18.79%. Individual company dumping rates were set as follows: Abitibi 12.44%; Weyerhaeuser 12.39%; Tembec 10.21%; Slocan 7.71%; Canfor 5.96%; West Fraser 2.18%. All other companies will pay the average dumping rate of 8.43%. The **combined CVD/AD** rate is now set at **27.22%**.

- On May 2, the U.S. International Trade Commission (ITC) released its decision that US producers are only threatened with material injury by Canadian lumber shipments to the U.S. Consequently, U.S. Customs are required to refund the bonds and cash deposits posted by Canadian softwood lumber companies prior to May 16, 2002.
- On May 22, 2002, Commerce published its final orders in the countervailing duty and anti-dumping case. As a result, the U.S. Customs requires cash deposits for duties on all softwood lumber imported from Canada since May 22, 2002.

Timetable for April 2, 2001, Countervailing Duty Petition to the U.S. Department of Commerce

Event	Agency	Days	Date
Petition filed	Both	0	2-Apr-01
Initiation of DOC Preliminary Investigation	DOC	21	23-Apr-01
DOC Questionnaire Released	DOC	29	1-May-01
ITC Preliminary Determination	ITC	44	16-May-01
Questionnaire Response Due	DOC	80	28-Jun-01
DOC Preliminary Determination/Bonds Due	DOC	129	9-Aug-01
DOC Verification	DOC		28-Jan-02 to 2-Feb-02
Submission of Briefs	DOC		18-Feb-02
Submission of Rebuttal Briefs	DOC		25-Feb-02
Hearing	DOC		28-Feb-02
DOC Final Determination	DOC	354	21-Mar-02
ITC Final Determination	ITC	410	16-May-02
Countervailing Duty Order Issued/Cash Deposits	DOC	416	22-May-02

Negotiations

- The United States and Canada have held discussions since July 2001 to assess whether there is an alternative to litigation to resolve the softwood lumber trade dispute. British Columbia and other Canadian provinces actively participated in these discussions. Alternatives to litigation may include changes in forest policy, which fall largely within the jurisdiction of the various provincial governments.
- During these discussions, British Columbia proposed a series of forest policy changes intended to form one component of an overall settlement of the dispute. This proposal includes a comprehensive set of forest

policy changes, all designed to create truly competitive markets for standing timber, logs and tenure; and expand the role of market forces in the forest sector. As a result, any "trade distortions"–real or perceived—that may be attributed to current British Columbia forest policies would be eliminated. British Columbia's public forest resources would continue under government ownership. However, government would focus on basic forest stewardship. Market forces would drive commercial decisions.

- Following two months of bilateral negotiations, the two sides exchanged proposals in early December 2001. Governments then consulted with their stakeholders, and talks did not resume until mid February 2002. After several weeks of intense negotiations, talks broke off on March 21, 2002. Agreement was not reached on the rate of the proposed transitional export tax, and issues related to provincial forest policy changes (including the percentage of the harvest to be auctioned in B.C.). In addition, the U.S. did not accept Canada's proposal for binding dispute resolution by an independent third party.

Note: More information on B.C.'s Softwood Lumber Proposal is available at:

http://www.for.gov.bc.ca/het/softwood/index.htm

WTO and NAFTA Challenges

- The federal government, the provinces and industry have launched a number of challenges related to the lumber cases.
- Challenges at the World Trade Organization (WTO) consider whether the U.S. has breached its obligations under the WTO.
- North American Free Trade Agreement challenges consider whether the U.S. has applied its own trade laws correctly.

Note: more information on Canada's NAFTA and WTO challenges of the softwood lumber duties can be found on the Department of Foreign Affairs and International Trade website at:

http://www.dfait-maeci.gc.ca/~eicb/softwood/legal_actions-e.htm

Market Diversification and Advocacy in Response to the Softwood Lumber Duties

- Both the federal and the BC governments have announced the establishment of wood product marketing initiatives in response to the US softwood lumber duties.
- On March 28, 2002, the Minister of Forests announced the BC government would spend $20 million on forest sector diversification and international marketing.

- On May 16, the federal government announced the creation of the $29.7 million Canadian Wood Export Program. This program is intended to expand Canada's wood exports in countries like China, Taiwan, Korea and India.
- On May 20, 2002 the Government of Canada announced it will contribute $20 million "to help Canada's softwood lumber industry raise awareness in the US of the impact of punitive US softwood lumber duties on US interests, and to step up Canada's advocacy efforts in the US". Funding of $17 million (over two years) will be provided to the Forest Products Association of Canada to "undertake a softwood industry-led campaign to raise awareness of the negative impact that softwood lumber duties will have on the US, and to encourage productive negotiations and resolution of the dispute". In addition, $3 million (over two years) will be given to the Canadian Embassy and Consulates in the US to enhance their efforts in this regard.

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